ISAE 3000\(^1\)—Issues and Task Force Recommendations

Background

1. ISAE 3000 was exposed for public comment in April 2011. Since the end of the comment period, the IAASB has discussed the project at its June, September and December 2012 meetings. The IAASB also received an education session by the Task Force on direct engagements at its February 2013 meeting.

Summary of Recent Significant IAASB Discussions

2. At the December 2012, the IAASB:
   - Asked the Task Force to continue to develop the ISAE using terms adopted in recently approved standards such as ISAE 3410\(^2\) and ISRE 2400.\(^3\)
   - Supported the Task Force’s efforts to distinguish the requirements for attestation and direct engagements via a tabular format in key areas. The Task Force was asked to consider whether an alternative presentation style, for example placing RA and LA in separate columns, and showing attestation and direct in separate rows, would further improve readability.
   - Supported application of proposed ISAE 3000 (Revised) by competent practitioners other than professional accountants. The IAASB also supported the Task Force’s proposal to include a new requirement for such competent practitioners to specify the code of ethics and quality control requirements used in their assurance reports.
   - Broadly supported the Task Force’s analysis of the strategic considerations, guiding principles and recommendations for the remainder of the project, which contemplate a vote on a final ISAE 3000 in September 2013. The IAASB also asked the Task Force to further consider how consequential amendments, including those to the Framework, could be undertaken before the completion of the project.
   - Expressed the view that ISAE 3000 should continue to cater for both direct and attestation engagements.

3. At the February 2012 IAASB meeting, the Task Force presented on the differences between direct and attestation engagements, common types of direct engagements and provided example reports of direct engagements.

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\(^1\) International Standard on Assurance Engagements (ISAE) 3000, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information

\(^2\) ISAE 3410, Assurance Engagements on Greenhouse Gas Statements

\(^3\) International Standards on Review Engagements (ISRE) 2400, Engagements to Review Historical Financial Statements

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Structure

4. This paper is structured as follows:

- Section I  –  Direct Engagements
- Section II –  Limited Assurance (LA) and Reasonable Assurance (RA)
- Section III –  Other Matters

Matters for Discussion

Section I – Direct Engagements

5. The Task Force has reflected on how this ISAE applies to and reflects the reality of direct engagements. As part of this effort, the Task Force and IAASB Staff reached out to two serving IAASB members (John Wiersema and Jonas Hällström) and one former IAASB member (Ian McPhee) who have experience with direct engagements in a variety of engagement circumstances. This outreach, in addition to the long standing participation of Andrew Baigent from the National Audit Office (UK) as a member of the Task Force, gave the Task Force a solid basis on which to evaluate the optimal path for the finalization of the ISAE in respect of direct engagements.

6. The Task Force notes that this outreach found the application of ED-3000 to direct engagements was sometimes difficult. In general, the views expressed were that ED-3000 did not resonate with their experiences and would be challenging for their staff to apply (as many of whom do not come from a financial statement attestation or accounting background). This concurs with the reaction of a majority of the respondents to the Exposure Draft (ED-3000) with backgrounds and experience in direct engagements.

7. However, the Task Force noted that the project proposal was explicitly framed to avoid reconsideration of the fundamental principles of assurance that were settled at the time extant ISAE 3000 was issued. To fully addressing these concerns would be outside of that project proposal, and would therefore be contrary to the strategic direction agreed by the IAASB in December 2012.

8. Nevertheless, the Task Force took the opportunity to reevaluate the possible approaches to addressing these concerns. Accordingly, the Task Force determined there were four options for the finalization of the ISAE:

   (a) Option 1 – Restart the project: Under this option, the project would be restarted to scope in the fundamental principles of assurance. This would enable a full response to direct engagements, but would require a new project proposal (approved in accordance with the IAASB’s due process) and the allocation of board and staff resources over a period of several years.

   (b) Option 2 – Continue with revision: Under this option, the Task Force continues to address direct engagements in the manner contemplated by the project proposal and the strategic direction, that is, by developing and amending requirements and application material to better address direct engagements, but not otherwise attempt to revise the fundamental principles.

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4 A total of eleven out of the fifty-seven respondents to the ED were organizations with significant public sector experience in direct engagements.
of assurance. Option 2 is in accordance with the project proposal and the IAASB’s strategic
direction to the Task Force.

(c) Option 3 – Minimalist approach: Under this option, the requirements and application material
addressing direct engagements would be removed, so that the standard only indirectly
addresses direct engagements. The introduction of the standard would contain words to the
effect that “this ISAE applies, as appropriate, to direct engagements.” This would avoid the
expenditure of IAASB resources in resolving the concerns of direct engagement practitioners,
but would come at the cost of applicability to direct engagements. It is also difficult to see how
the more granular requirements in ISAE 3000 could be “applied, as appropriate” to direct
engagements without application material to assist.

(d) Option 4 – Cancellation: Under this option, the project is immediately ceased. This would
save IAASB resources, but would also lose the progress achieved over the life of the project
and the opportunity to improve the quality of assurance engagements. It may also be seen to
imperil the standards that sit under ISAE 3000. Under this option, extant ISAE 3000 would
continue to apply unchanged in its pre-clarity form.

9. After debating the issues and options, and considering the public interest imperative to support high
quality assurance engagements (for both attestation and direct engagements), the Task Force
agreed that, given the current constraints, Option 2 (the current Task Force direction) remains
appropriate and in the public interest. The Task Force acknowledges that this means that
comments raised by respondents that require more fundamental changes (such as the replacement
of the concepts of “subject matter information” and “misstatement”) will not be addressed. However,
the Task Force believes that the concerns expressed can be addressed, expeditiously, by
development and amendment of requirements and application material to better address direct
engagements. This approach was also supported by two out of the current or former IAASB
members consulted (see paragraph 5).

10. Accordingly, the Task Force has considered what changes could be made to the ISAE that could be
completed within the parameters and timeline set by the strategic review. Accordingly, the Task
Force is proposing a number of related changes that will enable the ISAE to better address direct
engagements, while retaining material that is important for attestation engagements.

Description of Changes to Better Address Direct Engagements

11. A key component of these changes is that the paragraphs describing the practitioner’s work effort
have been split so that attestation engagements and direct engagements are dealt with separately.
Further, as requested by the IAASB at its December 2012 meeting, the Task Force has included a
columnar structure to separate the work effort associated with limited and reasonable assurance in
the same way as was done in ISAE 3410 (that is, with paragraphs marked “L” for LA and “R” for
reasonable assurance). Accordingly, the structure of the work effort paragraphs is as follows:
In this manner, the Task Force believes that practitioners performing each type of engagement can find the requirements and application material tailored to their circumstance.

12. Briefly, the key changes proposed by the Task Force to better accommodate direct engagements are:

- **Objective** – The objective has been broadened to include reference to the purpose and scope of the engagement. In contrast with financial statement attestation engagements (where the purpose and scope is often clear), direct engagement practitioners have to be clear on the purpose and scope of the engagement so the report issued will be relevant to the intended users (see paragraph 6 of Agenda Item 4-B). This change also affects other requirements throughout the standard, such as agreeing the terms of the engagement (paragraph 18(c)(ii) of Agenda Item 4-B); forming the assurance conclusion (paragraph 55A of Agenda Item 4-B), and the assurance report (paragraph 60(c) and A142A of Agenda Item 4-B). The Task Force notes that the concepts of “purpose” and “scope” may not be fully articulated in the ISAE yet, but believe that this is the right direction for the ISAE to take.

- **Changes to work effort to better reflect direct engagements** – new requirements and application material have been added for the following topics:
  - Selecting or developing suitable criteria – The Task Force has included new requirements for direct engagements that cover the selection or development of the suitable criteria. The Task Force has also proposed elevating application material addressing the characteristics of suitable criteria to a requirement, in recognition that this is a critical step in ISAE 3000 due to the broad range of engagements that will be covered by the standard (see paragraph 37AAA-42B of Agenda Item 4-B). An example has also been provided to illustrate a circumstance when the practitioner would have to determine the suitable criteria (see paragraph A10 of Agenda Item 4-B).
  - Measurement or evaluation – a new requirement has been added to mandate that, in a direct engagement, the practitioner must perform the measurement or evaluation (see paragraph 37AAL and 37AAR of Agenda Item 4-B). Further, application material has been added to clarify these terms (see paragraph A366 of Agenda Item 4-B).
  - Methodology for the measurement or evaluation – An additional requirement has been added for direct engagement practitioners to develop a methodology for the measurement or evaluation which responds to the identified risks (see paragraph 42AA(L)(c) and 42AA(R)(c) of Agenda Item 4-B).

- **Misstatement** – The definition of ‘misstatement’ has been redrafted to better reflect direct engagements by referring to “A difference, departure or deviation of the subject matter information from the appropriate measurement or evaluation of the underlying subject matter in accordance with the suitable criteria.” This definition applies to all assurance engagements under the ISAEs, including those where the practitioner’s conclusion is, or is part of, the subject matter information (see paragraph 8(n) of Agenda Item 4-B).
• Reporting – The Task Force has modified the requirements relating to unmodified and modified conclusions (see paragraphs 63 and 64 of Agenda Item 4-B). New application material has been drafted in support of the concept of pervasiveness and to illustrate how the different types of modified conclusions can result from different engagement circumstances (see paragraph A165A and Appendix 2).

Independence in a Direct Engagement

13. At its February 2012 meeting, some IAASB members asked how practitioners in a direct engagement could be independent, as the practitioner prepares the subject matter information and may be involved in selecting the criteria.

14. While setting independence requirements for assurance engagements is not within the mandate of the IAASB, the Task Force notes that the IESBA Code specifically permits direct engagements. The practitioner in a direct engagement is independent for two reasons, being independent of the party responsible for the underlying subject matter and being independent of the underlying subject matter itself. The practitioner is not independent of the subject matter information itself, as the practitioner creates the subject matter information. IAASB staff has previously liaised with IESBA staff, which confirmed IESBA’s current position on the issue, and will continue to do so.

Matters for IAASB Consideration

1. Does the IAASB support the Task Force’s decision to pursue Option 2? (see paragraph 8)

2. What views does the IAASB hold in relation to the Task Force’s proposed changes to better address direct engagements?

3. Does the IAASB see merit in the Task Force’s proposed inclusion of reference to the “purpose and scope” of the assurance engagement? What improvements could be made?

Section II – LA and RA

Procedures in a LA Engagement

15. At its December 2012 meeting, the IAASB asked the Task Force to continue to develop the requirements and application material for LA using terms adopted in recently approved standards such as ISAE 3410 and ISRE 2400. This reflected the view that uses terms in ordinary usage such as “may,” “likely,” and “not likely” in key work effort paragraphs is understandable to practitioners and will result in the appropriate work effort.

16. The IAASB also asked the Task Force to consider whether application material could assist in explaining the key work effort requirements where these terms were used. In response to this request, the Task Force has inserted additional application material to explain the “deep dive”; that is, the procedures required when a matter comes to the practitioner’s attention that causes the practitioner to believe the subject matter information may be materially misstated (see paragraphs A98–A98C of Agenda Item 4-B). The application material notes that professional judgment is needed to determine the nature, timing and extent of additional procedures and provides examples of when additional procedures may and may not be needed. It also highlights that the practitioner’s judgment is guided by:
Differences in the Timing of Procedures

17. Paragraph 8(a)(i)(b) of Agenda Item 4-B explains that “The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain assurance that is, in the practitioner’s professional judgment, meaningful.”

18. However, the application material provided for “timing” (see paragraph A1A of Agenda Item 4-B) has proved to be difficult to draft, although the Task Force has had several attempts. This is because it is difficult for the Task Force to find an example which is truly a timing difference, rather than a difference in the nature or extent of procedures. It is notable that ISAE 3410, which also uses the term “nature, timing and extent of procedures” also did not explain how timing could vary.

19. Accordingly, the Task Force proposes that the requirement and application material that suggests that “timing” should differ between LA and RA be deleted. This would require a conforming amendment to ISAE 3410 as well.

Matters for IAASB Consideration

4. Does the IAASB support the additional application material to support the LA work effort paragraphs? What further application material would assist in supporting LA engagements?

5. Does the IAASB support the Task Force’s proposed deletion of the application material to explain how “timing” of procedures could vary between LA and RA? Alternatively, are there views or suggestions to assist in developing the application material further?
Section III – Other Matters

Presentation of LA, RA, Direct and Attestation Engagements

20. The Task Force has reordered and represented the work effort paragraphs (paragraphs 37 to 42B of Agenda Item 4-B) to adopt the LA and RA columnar format used in ISAE 3410. This promotes consistency within the IAASB’s literature, and enables the paragraph numbering (ie. paragraph 37(L) for LA and 37(R) for RA) to be easily understood by users of the standard.

21. Further, requirements for direct and attestation engagements have been separated in the work effort paragraphs as indicated in paragraph 12 above.

Matters for IAASB Consideration

6. Does the IAASB support the presentation of the work effort paragraphs in a columnar format for LA and RA, and a separation of the requirements for direct and attestation engagements?

Reporting – Basic Requirements

22. The Task Force has revised the requirements for the assurance report to ensure that the requirements are applicable in virtually all assurance engagements. In particular, in view of the broad remit of the standard, some of the reporting requirements found in ISAs were not considered to be mandatory for the ISAEs. For example, the requirement that the modification is described in a “paragraph” is difficult to reconcile with long form reporting where the basis for the modification can be described over several paragraphs or more (see paragraph 60).

23. As a result of these changes, some of the requirements have been amended (for example, the “paragraph” example above) and some have been moved to application material. The most noticeable of this latter group is that headings for the modification and basis for modification sections are not proposed to be mandatory. The Task Force is of the view that the IAASB wishes to encourage innovative reporting and evolution over time, and so it is desirable to avoid a rigid structure of reporting but to nevertheless require the key elements of a high quality assurance report.

Reporting – Dirty Assertions

24. ED-3000 included the following requirement, which addresses the “dirty assertion” when the responsible party correctly and adequately acknowledges that the subject matter information is materially misstated:

67. In an attestation engagement, when the statement made by the responsible party has identified and properly described that the subject matter information is materially misstated, the practitioner shall either:

(a) Express a qualified or adverse conclusion worded in terms of the underlying subject matter and the criteria; or

(b) If specifically required by the terms of the engagement to word the conclusion in terms of statement made by the measurer or evaluator, express an unqualified conclusion but emphasize the matter by specifically referring to it in the assurance report. (Ref: Para. A165B)
25. However, the Task Force believes that giving a qualified or adverse conclusion when the responsible party has acknowledged (and clearly stated in the subject matter information) that the subject matter information is materially misstated is not conceptually sound. This is because if the statement by the responsible party correctly and adequately describes the material misstatement then a modified conclusion adds little informational value to users. Rather, the Task Force prefers that the conclusion be unmodified and expressed in terms of the responsible party's statement with an emphasis of matter. This would provide users of the subject matter information with a signpost to the material in the subject matter information that describes the material misstatement.

**Matters for IAASB Consideration**

7. Does the IAASB support the changes described in paragraphs 19 and 20, particularly to not mandate headings for the "modification" and "basis for modification" paragraphs?

8. Does the IAASB support the Task Force's proposal to require an emphasis of matter when the responsible party gives a "dirty assertion"?